Abt Associates Inc.

Assessing the impacts of privatization: The experience of Morocco

Executive summary

1 Study mandate

Privatization of state-owned enterprises has been at the core of economic restructuring efforts across countries. Its proponents have marshaled persuasive economic as well as political arguments that private ownership and management of productive assets will restore or enhance the financial health of the state-owned enterprise sector, do away with distortions and special privileges, and contribute to equitable economic growth. For selected impact categories, in particular microeconomic gains in enterprise performance, a growing body of literature has succeeded in rounding up convincing empirical evidence. Yet on the whole, the understanding of how privatization policies and procedures affect outcomes and impacts remains too tenuous to guide program management in a given political and institutional setting.

The search for reliable empirical guidance faces both conceptual and practical problems. At the conceptual level, privatization virtually always forms part of broader economic policy reforms, making attribution difficult. In some instances, the attribution is obvious: one can claim with some confidence that any creation of wealth in the form of shareholdings among small investors is a direct result of set-asides and special facilities in the privatization program. In other instances, the counterfactual argument (what would have happened in the absence of privatization) is less evident; the choice of the reference case may greatly influence the findings.

The practical difficulty is the dearth of reliable empirical information common to most developing countries. Although researchers have made considerable progress in compiling data sets on company performance within and across countries, coverage remains limited. Few privatization programs have attempted to track systematically indicators across the full range of impacts of political or programmatic importance.

Yet policy makers and program managers need feedback and guidance on the impacts of privatization and how they are shaped by their decisions and actions. The US Agency for International Development (USAID) therefore has sponsored this study to address two principal concerns — structuring a pragmatic approach to the evaluation of privatization programs, and applying it to the case of Morocco, in part to contribute to the country's current deliberations over the future course of its program. The emphasis is on assessing impacts across the entire spectrum of privatization objectives, rather than focusing on a few selected issues in depth.

2 The analytical framework

2.1 The range of program objectives

The objectives of privatization that emerge from policy statements, public debate and program implementation span a wide range, from general notions of boosting the role of the private sector to sector and enterprise-specific changes sought. Any comprehensive attempt to assess the impacts of privatization needs to reflect this richness of concerns. Yet covering the complete spectrum of impacts also means dealing with the full panoply of factors and forces that influence them, in the context of structures and behaviors that are undergoing often radical change.

In principle, though, these challenges faced by the appraisal of the impacts of privatization are no different from those for any policy or program evaluation. In all instances, the impacts themselves are complex, as are the forces that determine them. The structure that links them is changing in fundamental aspects, in part as a result of the interventions and accomplishments of the program that is being evaluated. The dynamic interactions between the program and its environment blur the distinction between exogenous and endogenous elements. By affecting its environment and its structural characteristics, the program redefines conditions for downstream performance. In other words, an evaluation of the impacts of privatization designed to contribute to continuing program design and implementation must treat the objectives themselves in a dynamic context — they are shaped by the economic and social context, and evolve as the context changes, in part as a result of program interventions and accomplishments.

Dealing with this complexity and structural change over time with methodological rigor would call for relatively sophisticated "data-hungry" analysis techniques. In privatization programs, as in many other policy initiatives in developing countries, satisfactory longitudinal data are rarely available to meet that hunger — implying the need to revert to second or third-best analytical approaches that seek to extract useful insights from the limited data available. Placing such approaches in the context of a clear conceptual framework makes the task easier and strengthens the validity of findings.

2.2 Elements of the framework

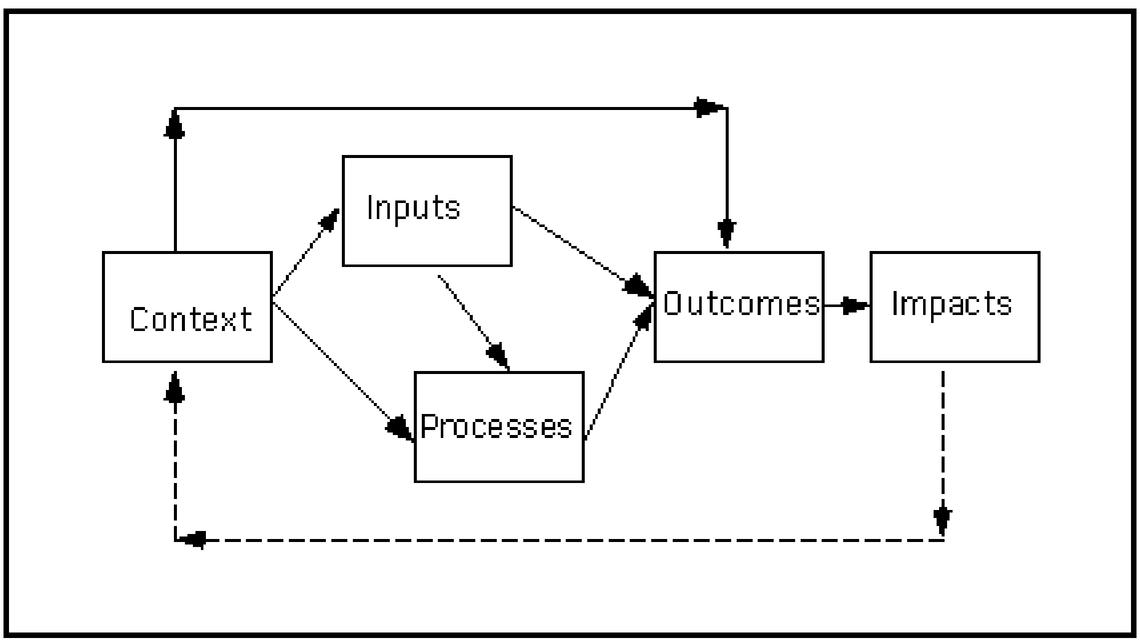
2.2.1 Overview

The concepts and techniques developed for policy appraisal and policy impact assessments in a wide variety of settings prove useful in structuring the appraisal of privatization impacts, using the following elements:

- context;
- inputs;
- process;
- process achievements or outcomes; and
- impacts.

Exhibit 2-1 sketches a simple schematic of this analytical structure. It should be viewed in a dynamic context, since privatization is a continuing process. Building on earlier reforms, programs reshape their environment, thereby setting the stage for future performance. In the schematic presentation, the feedback loop from the impacts to the context attempts to capture this dynamic interaction.

Exhibit 2-1: Analytical framework



2.2.2 Context

The overall economic, political and social environment determines the explicit and implicit objectives for the privatization program, and imposes constraints. The analysis of the context cannot be limited to an assessment of the conditions when the program was launched. Instead, it requires a dynamic approach: both antecedents of the program, such as prior reforms of the state-owned enterprise sector, and its interplay with forces and developments beyond the control of the program managers during implementation are crucial in shaping the course, outcomes and impacts. In effect, objectives are stated in terms of desired changes in context characteristics; impacts are observed changes in such characteristics that can be attributed to the program.

2.2.3 Inputs

Within the constraints defined by the context, the program manager chooses the amount and characteristics of resources devoted to implementation. Of particular interest here is the mobilization of technical and managerial expertise to prepare and carry out the transfer of state-owned enterprises to private ownership.

2.2.4 Processes

Together, the context and available inputs shape the choice of processes and procedures, the way in which the program's *functions* are carried out. These functions include enterprise selection, valuation, choice of privatization modalities, selection of investors, creation and strengthening of the legal and regulatory framework, development of institutions, communications, and impact mitigation measures.

An important aspect in the process evaluation is the appraisal of the underlying principles that shape the "program culture." These principles include such elements as decisiveness, openness, transparency, and participation in the choice and management of privatization-related procedures.

2.2.5 Process accomplishments or outcomes

This element of the analytical framework refers to the assessment of the direct results of the privatization program. These results include the value of assets transferred, the shares issued and their distribution, the proceeds raised, or the conditions of sale agreed upon.

2.2.6 Impacts and impact categories

Program impacts refer to the *changes in the context* attributable to the program outputs — to what extent has the program achieved its objectives and alleviated constraints? The appraisal of impacts constitutes the core of any program evaluation. For privatization programs, the major impacts of interest can be defined in terms of the stakeholders affected:

- for the government, the short and long-term *fiscal impacts*;
- for the enterprises themselves, impacts on *financial health and performance*;
- for the investors, including strategic, institutional (portfolio) and small investors, *returns on investment*;
- for the workers of the privatized enterprises, effects on *employment levels and employment-related benefits*;
- for the broader business environment, impacts on the *legal and regulatory framework*, on *corporate governance*, and on *institutions*;
- for consumers, changes in terms of *price, quality and availability of goods and services*; and
- for the business partners of the enterprises, especially suppliers, effects on the *demand* for their goods and services.

2.2.7 Interaction and feedback

An evaluation should guide programmatic choices to achieve the best possible results. This task calls for an analysis of the linkages among the elements of the analytical framework outlined here, in particular the relationship between programmatic choices (processes and inputs) and the impacts of the program, given the evolving context. In practical terms, the analysis of such linkages must rely on a range of methods, including qualitative as well as quantitative techniques.

2.3 Study approach

The application of the framework to the case of Morocco was the task of a study team that comprised four members focusing on economic aspects, financial performance and employment-related impacts, respectively.[1] Much of the data gathering occurred in the field during two visits to Morocco in September/October 1998 (all), and in November/December 1998 (Team Leader only). In addition to efforts to pull together the available statistical and financial information for quantitative analysis, the study team conducted a series of interviews with experts and participants in the privatization program, including interviews with individuals who could provide a sectoral perspective. We complemented that with visits to several enterprises to interview company management.

Studies of the impact of privatization on workers not overlook the workers themselves as sources of information and judgment. We therefore arranged for group interviews (or "focus groups," although the sessions did not fully follow a strict focus group protocol) with workers of privatized enterprises to obtain their views and reactions. We found it easy to establish rapport with the workers and to elicit their responses.

3 Conclusions and recommendations

3.1 Overall findings

Douglass North has argued that successful privatization programs improve both allocative and adaptive efficiency. They serve *allocative efficiency* by awarding control and management of assets to those economic agents that value them most. They serve *adaptive economic efficiency*, which North and others see as the key to enhanced performance of the economy, by creating and strengthening the appropriate institutional framework of beliefs, rules, procedures, and organizations. In our view, the Moroccan program has registered some gains at the microeconomic level, in accordance with expectations, with few apparent adverse effects. The program's more important contribution, though, may have been at the macroeconomic level. The way in which the privatization program was managed, including the deliberate underpricing of assets sold, has helped build and strengthen the kind of institutional framework for raising adaptive efficiency.

The privatization program has slowed in recent years, with the last share issue privatization in 1997. The main emphasis in the coming months and years should be to regain the momentum, which has been

[1] The team included: Ulrich F.W. Ernst, economist and team leader, Tyler Holt, coordinator, Peter Gregory, labor economist, and Deborah Gladstone, financial analyst. Nelson Edwards contributed to the design of the financial analysis.

lost, and to focus on building the structures, especially regulatory structures and capabilities, needed to support and sustain private sector participation, in particular in the infrastructure sectors.

3.2 Specific findings and recommendations

Other conclusions of the appraisal of the impacts of Morocco's privatization program can be summarized in the form of ten propositions and associated recommendations:

(1) Given the complexity of the program in terms of range of demands that were placed on it, the performance has been respectable, with an average of 10 companies privatized per year during the "active phase" of the program (1993-97). Morocco allocated significant resources, including the creation of a new Ministry dedicated to the task of privatization, and received additional support from donors. By relying on consulting firms and investment banks, the Government leveraged these resources. Even so, the scope of the program was ambitious in terms of the number of companies to be privatized on a case-by-case basis, and in terms of the modalities of privatization — a preference for public tender, detailed valuation, consideration of investment commitments, protection of jobs and employment-related benefits, etc. The resources available to the program managers were the not commensurate with the scope of the program.

- The solution is likely to lie in a more realistic approach. Only a few key enterprises demand the detailed attention typical for a case-by-case privatization. Especially now that Morocco has experience with privatization, many of the smaller cases and divestiture of partial state ownership can be handled in a more standardized and expeditious manner. Simplifying the evaluation criteria and standardizing the tender process can yield better results for the privatization effort — revenues relative to the transaction cost. Relying on standardized approaches, documents and procedures would allow for a greater volume of transactions. The notion of relying on a small core staff is appropriate, but implies a role as program manager and supervisor rather than as an agent involved in all aspects of the process. With the growing sophistication of domestic and international investment banks and financial advisers active in Morocco, the attention should shift to designing systems of incentives and supervisory mechanisms to achieve the objectives of privatization through private sector mechanisms. For example, strategic investors could now handle IPOs at least as effectively as the government.

(2) The privatization program has had a major impact on the development of the Casablanca Stock Exchange in terms of market capitalization, trading activity, participation, corporate governance and performance. Privatization provided the impetus for improved financial disclosure standards and regulatory reforms. In our view, the privatization program has contributed significantly to improvements in "adaptive efficiency" of economic institutions. It is worth noting that we found it easier to obtain detailed financial and other information on publicly traded companies from private sources rather than from the public institutions. We see that as a sign that disclosure and surveillance have become part of the business environment, albeit limited to certain layers of the economy.

- The major challenge in the coming years is to build on these accomplishments by expanding the number and range of companies traded on the Bourse, and to continue to strengthen the supervisory mechanisms critical to containing systemic risks and ensuring transparency.

(3) Other impacts show a mixed picture. Fiscal impacts probably were negative, implying a net transfer from the public to the private sector, in large part as a result of deliberate underpricing in pursuit of broader social objectives. An analysis of a sample of publicly traded companies suggests that the financial performance of the privatized companies improved, but we did not find significant trends or shifts in selected financial indicators.

- While there is nothing wrong with accepting reduced proceeds in exchange for "social benefits," the tradeoffs should be made explicit. Relying solely on valuation for setting prices for share issues at the Bourse involves considerable uncertainty (since valuation rests on projections of performance). It should be complemented by other techniques, such as book-building. Alternatively, the process can be further streamlined by tasking strategic investors with the preparation and implementation of subsequent IPOs.

(4) With one major exception, a company embroiled in a dispute with the Government, we found no significant impacts on employment and employment-related benefits. As a group, privatized manufacturing enterprises showed no change in total employment over the period 1990 to 1996, and more recent evidence suggests that total employment in the privatized companies actually increased by 6.5 percent. This result is partly due to selection bias (lack of serious overstaffing was a criterion of selection), partly to provisions in the conditions of sale (*cahiers des charges*), and partly to a traditional respect for employment relationships. Employees in a number of companies benefited from efforts to facilitate their participation in the privatization. However, communications with workers and their participation in the process were inadequate, especially given the commitment to transparency on the one hand, and the emphasis on protecting workers' rights and privileges on the other.

- The program needs reach out to the workers as a matter of course to familiarize them with the process and make them part of the privatization process. Effective communications with the stakeholder group most directly affected should be an integral part of all privatization efforts. It becomes part of the drive to change the business culture and enhance adaptive efficiency.

(5) The scope of the privatization program, as outlined in the enabling legislation, was rather ambitious, given the insistence on a carefully prepared case-by-case approach. While the list of "privatizables" may have been intended to define the universe for privatization, it has been widely interpreted as a target list, with specific deadlines. That may have affected perceptions of the success of the program, but also shaped the operating environment for companies that remained "on the block" for nine years without being privatized. With an uncertain status and a lame-duck management, the performance of these companies is likely to have suffered. We do not believe that the answer is a one-year program of targets, as proposed. There are always unforeseen opportunities and complications, and mid-stream adjustments confuse investors and management. Nor is the answer to keep the targets secret (as Tunisia has sought to do), because information will leak, and rumor and confusion are likely to be the result.

- A reasonable compromise is a "rolling" three-year target list that is updated every year, with rolling one-third of the companies assigned a priority for the first year. At the same time, efforts should be made to lower the profile of the respective *Ministère de tutelle* and expose the enterprises to competition and allow them to respond to competition in a market-oriented manner. Privatization should proceed in tandem with continuing reforms of the rules and procedures governing the management of state-owned enterprises, including increased transparency and accountability.

(6) The privatization program has focused on the sale of assets wholly or partly owned by the government. Using four main methods, it has sought to ensure transparency by stressing tenders and share issues on the stock exchange, reverting to private placement whenever necessary. To our knowledge, the program has had only marginal involvement with other privatization initiatives in the Kingdom of Morocco, notably private sector participation through concessions in infrastructure sectors (water, electricity) or other forms of private-public partnerships.

- We support current efforts to approach all forms of privatization in a coherent framework; however, we would caution that these efforts not delay swift progress on privatization initiatives now under way in infrastructure sectors. The main emphasis now is on the development of appropriate regulatory structures and capabilities to complement the growing involvement of the private sector.

(7) There has been no adequate monitoring of the performance of the privatized companies, apparently not even with respect to their commitments under the sales contracts (*cahiers des charges*), such as job protection — although large-scale layoffs would become known very quickly. While the program has established a reputation for transparency and fairness, it is easy to imagine situations in which an investor fails to live up to certain commitments and therefore in effect invalidates the reasons for selection.

- If the scope and complexity of the program expand because the Government feels compelled to insist on a range of criteria and conditions, there must be sufficient resources to monitor and enforce compliance. Without such provisions, the potential for (actual or perceived) abuse exists.

(8) A similar proposition applies to investment commitments. Seeking such commitments and using them in the evaluation of bids is a commonly accepted element of privatization programs. The post-privatization role of such investment commitments, however, has typically been problematic, even if adequate resources can be allocated to monitor the investment performance of the new owners (as in Germany). Actual investments are not always easy to confirm. Moreover, any investment plans over an extended period of, say, five years are subject to revision as market conditions change. Whether the adjustments are reasonable within the scope of the contract then becomes a matter of negotiation between the government and the investor — opening the door to discretionary actions.

- As long as only qualified, reputable bidders are allowed to participate in a tender (typically through an appropriate prequalification), planned investments become part of their own business plan and therefore part of their valuation, which in turn determines the price they are willing to offer. Substituting bureaucratic judgment for the judgment of the investor by using investment commitments as an evaluation criterion raises certain questions — especially when the resources for monitoring and enforcement are scarce. However, if proposed investments factor in the evaluation and selection of bids, mechanisms must be in place to ensure that investors honor these commitments, or that adjustments are negotiated in an open and transparent manner.

(9) Proceeds from the privatization program have been treated in effect as part of the "normal" revenues of the Treasury. That approach foregoes an opportunity to demonstrate the beneficial impacts of privatization by earmarking proceeds for some concrete purpose, either debt reduction or selected social investments. Moreover, it can complicate the Treasury's cash management and unsettle the market for government securities. The use of privatization bonds or similar instruments can further contribute to this problem. While they are in principle useful tools in smoothing out cash receipts from privatization, they require careful coordination between the Treasury's management of government securities and the sale of real assets.

- To exploit opportunities to build further political support for privatization and to protect government securities markets against disturbances, proceeds from privatization should be treated as extraordinary revenues and earmarked for special purposes.

(10) The management of share issues has been marked by largely deliberate underpricing, yielding sometimes spectacular oversubscriptions, and ensuring rapid appreciation immediately after privatization. Such an approach often results in a "flowback effect," when investors, especially small investors, sell their shares to cash in on their windfall gains. This effect has been limited in Morocco, in part because the market as a whole has been buoyed by the mobilization of domestic investment capital, lack of placement alternatives, and the relatively small number of traded companies.

- As these conditions change, future privatizations may require different approaches to pricing, and provisions to protect against excessive price swings, in particular the flowback effect.